

provisional decision	
complaint by:	Ms P and Mr M
complaint about:	ABC Limited
complaint reference:	
date of decision:	November 2011

summary of complaint

This Provisional Decision is issued by me, Tony Boorman, an ombudsman with the Financial Ombudsman Service. It sets out my provisional conclusions in relation to the dispute between Ms P and Mr M and ABC Limited – an independent financial adviser (IFA).

This dispute is about the advice given to Ms P and Mr M by the IFA to invest in the CF Arch cru Investment Portfolio (the Arch cru fund) in 2008.

I have carefully considered all the information and evidence submitted by both sides, in order to decide what is fair and reasonable in the circumstances of this complaint. For the reasons I set out below my provisional decision is that I should determine this complaint in favour of Ms P and Mr M. This is a provisional decision and is subject to any further comments and evidence that I receive from the parties. Subject to that further evidence and representations I intend to issue a Final Decision in the following terms.

background to complaint

a) events leading up to the complaint

In early 2008 Ms P and Mr M sought investment advice from the IFA. They had recently sold a property and held about £50,000 in various cash deposits. They did not hold any other (non-pension) investments or significant savings but were hoping for better returns than they were then earning on their deposit account. They wished to hold significant funds in cash against the prospect of reducing a fixed rate mortgage they held that in certain circumstances allowed some 'over-payments'.

Acting on the advice given by the IFA both Ms P and Mr M made investments of £4,000 (each) in the Arch cru fund and these were each placed in a stocks and shares ISA.

In March 2009 dealings in the Arch cru fund were suspended. Ms P and Mr M were concerned about the performance of their investment and the extent of the forecast losses.

b) the complaint and the firm's response

Ms P and Mr M complained to the IFA and asked for an explanation of how despite a generally cautious attitude to any investment risk they had been recommended a fund which appeared to be far more risky than they had been led to understand.

The IFA noted the advice it had given and the wider regulatory and other steps that were taking place in respect of the Arch cru fund. The IFA said that its advice had been sound on the basis of the research it had been able to carry out. There had been widespread and significant disruption to financial markets that had adversely impacted almost all investments. If there were particular problems with the Arch cru fund this was the responsibility of that fund's managers and was not something the IFA could accept any responsibility for.

Ms P and Mr M were not satisfied by this response and referred their complaint to this service. They say the advice was unsuitable for them because investing in the Arch cru fund presented more risk than they were prepared to take.

The complaint was investigated by one of our adjudicators, who recommended that the complaint should succeed.

The IFA did not accept the adjudicator's assessment. In summary it said:

- The advice was appropriate and in keeping with Ms P's and Mr M's stated objectives. The investment accounted for 17% of the overall portfolio with the rest retained in cash for liquidity and stability – a low risk strategy.
- The clients, having digested the 'attitude to risk' document, selected their tolerance. This indicated that not all the funds would be in cash and fixed interest. The fund itself held 25% in cash. The diversity of assets and the fact Ms P and Mr M retained 83% of their money in cash meant that the overall portfolio was within their stated risk tolerance
- Ms P and Mr M were not inexperienced – they have pension arrangements which mirror their risk profiles and therefore do have investment experience and experience of market volatility.
- The funds did not necessarily present higher risks, but different risks.
- Many of today's household names have been funded via private equity and private finance arrangements; mostly short term loans secured against assets.
- Companies welcome such arrangements because the backers have a vested interest in its future success and can offer experience and guidance by being part of the management team.
- Whilst there may be examples of higher rates being charged to borrowers in the private market it is often not just about the rates but the terms of the finance and the restrictive and onerous covenants that the banks seek to apply.
- The losses incurred were not foreseeable. The investment and specialist portfolios had 94.87% and 92.31% positive performance months with maximum downturns of 2.43% and 5.53% respectively over a three year period. A 50% decline in one month was not foreseeable.
- Although there could be liquidity issues in extreme circumstances, the fund held 25% in cash, more than enough to meet ordinary short term needs.
- If it had recommended an investment in the same peer group, Ms P and Mr M would also have lost money following the collapse in the markets in late 2008.
- The issue with the Arch cru fund is the inappropriate/incorrect or even fraudulent valuations of assets by auditors/actuaries (and not the asset held). That was not something an IFA could have established with reasonable due diligence.

- An adviser can undertake proper due diligence at the outset but relies on the fund managers operating within the trust deed or rules of the scheme. It trusted Capita Financial Managers Ltd (Capita) to do its job as ACD. Investors and regulators should look to Capita for compensation.
- If a fund gains authorisation from the regulatory bodies this implies an element of trustworthiness. When a fund is advertised as lower risk and operates outside of those parameters the IFA cannot be held responsible.
- The suitability letter is merely a record confirming what has been arranged and supports other literature as a whole. Its object was therefore to provide a synopsis, not a full regurgitation of every document verbatim.
- The fate of the investment revolves around asset valuations and not necessarily the type of asset held; information that would not have been available to anyone outside of the auditors themselves.
- The proposed award is inappropriate as it assumes Ms P and Mr M would have invested in something with a guaranteed return, but that does not match their risk profile – they did not stipulate ‘no risk’.
- In any event, Capita is ultimately responsible and should pay the compensation.
- The investment was recommended as a minimum five year holding and until that time has elapsed and any potential losses accurately assessed, any award is unwarranted.

Ms P and Mr M have raised no objections to the adjudicator’s opinion.

As the IFA did not accept the adjudicator’s opinion the complaint has been passed to me for review.

my provisional findings

I have included only a brief summary of the complaint (above), but I have read and considered all the evidence and arguments available to me from the outset, in order to decide what is fair and reasonable in all the circumstances of this complaint.

a) relevant considerations

When considering what is fair and reasonable, I am required to take into account relevant: law and regulations; regulator’s rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

The IFA gave Ms P and Mr M advice about a regulated investment product in February 2008. It is important to note the relevant regulatory regime that applied at the time.

The FSA principles apply to all authorised firms including the IFA. Of particular relevance to this complaint is:

- **Principle 6**

“A firm must pay due regard to the interests of its customers and treat them fairly”

- **Principle 7**

“A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading”

- **Principle 9**

“A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment”.

In addition, where investment advice is given, the more detailed FSA's Conduct of Business Sourcebook rules, which came into force on 1 November 2007, apply. And so it is relevant to take those into account. Of particular relevance to this complaint are:

COBS 9.2.1R

(1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.

(2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:

(a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;

(b) financial situation; and

(c) investment objectives;

so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.

COBS 9.2.2 R:

(1) A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:

(a) meets his investment objectives;

(b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

(c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

(2) The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

(3) The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

COBS 9.3 sets out Guidance on assessing suitability:

COBS 9.3.1G

- (1) A transaction may be unsuitable for a client because of the risks of the designated investments involved, the type of transaction, the characteristics of the order or the frequency of the trading.*
- (2) In the case of managing investments, a transaction might also be unsuitable if it would result in an unsuitable portfolio.*

COBS 9.2.3 R

The information regarding a client's knowledge and experience in the investment field includes, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved, information on:

- (1) the types of service, transaction and designated investment with which the client is familiar;*
- (2) the nature, volume, frequency of the client's transactions in designated investments and the period over which they have been carried out;*
- (3) the level of education, profession or relevant former profession of the client.*

If a firm has supplied a 'suitability report':

COBS 9.4.7R

The suitability report must, at least:

- (1) specify the client's demands and needs;*
- (2) explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and*
- (3) explain any possible disadvantages of the transaction for the client.*

COBS 9.4.8G:

A firm should give the client such details as are appropriate according to the complexity of the transaction.

I am also mindful of the general legal position including: the law relating to negligence, misrepresentation and contract (including the express or implied duty on professional advisers to give advice with reasonable skill, care and diligence); and the law relating to causation and foreseeability.

There is no dispute that this was an advised sale of an investment product where the IFA firm assessed the suitability of the product for these (potential) investors.

Therefore, taking the relevant considerations into account, it seems to me that the overarching question I need to consider in this case is whether the recommendation to invest in the fund was a suitable recommendation for the consumers in their individual circumstances.

In deciding this question I need to take into account the nature and complexity of the investment and the consumers' financial circumstances, needs and objectives; understanding and relevant investment experience; and tolerance to investment risk.

If having considered all the relevant circumstances, I find that the recommendation was unsuitable for the consumers, I then need to consider:

- whether they relied on the recommendation and have lost out as a consequence of that (by considering what the consumers would have done 'but for' the poor advice); *and*
- if they did, how fair compensation should be calculated in all the circumstances of the case.

b) *was the investment a suitable recommendation?*

The IFA recommended Ms P and Mr M each invest £4,000 in a stocks and shares ISA invested in the Arch cru fund. At the time:

- Mr M was 54 and Ms P was 42.
- They lived together, but did not have any dependants.
- They had recently sold a property and had about £50,000 held on deposit.
- They did not hold any (non-pension) savings or investments other than the deposit accounts mentioned above.

The documentation from the time of the sale records that Ms P's and Mr M's priority was to look at some tax efficient investments that may provide some growth opportunities over the medium to longer term that could deliver potentially better returns than cash deposits.

Ms P's attitude to investment risk was recorded as 'realistic', (or 5 on a ten point scale) described as:

'You would like to benefit from long term investment return but are wary of stock market volatility and would like to make some compensation by means of low risk investment.'

Mr M's attitude to investment was recorded as 'cautious to realistic' (or 4 on a ten point scale) described as:

'You would like to ensure your short term financial security through low risk investment but also wish to benefit from long term investment returns to provide for future security.'

Ms P and Mr M say that they made it clear to the adviser that they were looking for an investment with a low/cautious risk profile.

It seems to me that in making any recommendation the obligation on the IFA was to identify a suitable product that met these clients' needs. I intend no offence to the IFA by saying that at the time it was I understand a modest sized business, without access to extensive private research. Rather, like many IFAs it needed to exercise good professional judgement based on its own general knowledge of investments and markets, public research and the information provided by product providers.

I understand it had no special access to information from, or involvement with, the Arch cru fund or its fund managers and related companies.

I have therefore carefully considered the documentation provided by the IFA relating to the Arch cru funds, much as I am sure that the IFA did before making its recommendations. In the September 2007, for example, the Arch cru fund monthly report recorded the fund as Investment Managers Association (IMA) fund sector “cautious managed”. Arch cru said in its fund overview:

‘CF Arch Cru Investment Portfolio is a multi-asset open-ended investment company (OEIC) that targets consistent returns with a significant focus on risk management. The fund invests in both public market securities (equities, bonds, real estate) and private investments.

Because of the risk techniques employed and the total return mindset, the Portfolio has genuinely low correlation with traditional public investments such as bonds and equities.

Notwithstanding the significant disturbances that took place during the summer months in public equity, bond, credit and property markets our two UK onshore OEICs continue to deliver steady positive returns. In September, the Investment Portfolio registered a return of 0.57%; for the year thus far, the fund has returned 8.42%, a monthly average of 0.94%. The aim of the fund is to generate an annual return to investors of cash + 4%. In 2007, returns have been achieved through almost exclusive exposure to private assets and markets. Our central investment premise since inception of the Fund has been that public markets did not represent sufficient future reward relative to the risks being taken. In addition, we have been concerned about the distinct lack of diversification and high level of correlation of public market investments during times of distress. Underlying returns for both the Investment and Specialist Portfolio remain very healthy’.

In the same document Arch cru sets out what it describes as its “strategy allocation (broad)” in the form of a pie chart. These were:

- *Private equity (28.4%)*
- *Private Finance (23.6%)*
- *Sustainable Opportunities (17.6%)*
- *Cash (committed) (10.6%)*
- *Structured Finance (8.4%)*
- *Real Estate (7.1%)*
- *UK equity Income (3.2%)*
- *Water and Power (0.8%)*
- *Clean Tech (0.3%)*

Arch cru also described its Investment Portfolio as follows:

‘This is our flagship fund. Its objective is to generate consistent returns that, particularly when viewed over the medium to long term (minimum of 5 years plus), exceed cash deposit returns by 3-4% per annum after all fees. We believe our investment approach provides for the two key long term aims of the private client: wealth preservation and capital appreciation. You should understand that this target return cannot be guaranteed and that both the return and your capital is at risk. The Fund majors in private market investments, such as private equity and private finance. It also invests in sustainability assets, focussing on companies and others who will profit from the solutions to the global issues of climate change, population growth and urbanisation.’

What might a reasonably informed IFA conclude from this and the other information that was reasonably available to a professional adviser?

First the fund was targeting a reasonably significant return after its fees - 3 or 4% above cash deposits over 5 years. As a general proposition, I understand that such targeted returns would normally imply an investment approach that involved a significant degree of risk.

There were indications of where some of those investment risks were being taken. I note that the private equity element within the portfolio was described as being equity stakes in medium sized pan-European firms. It was clear that this type of investment was a significant component of the overall fund (at that time).

Arch cru described its Private Equity Fund as:

“the Arch Cru Private Equity Fund provides investors with access to opportunities that have traditionally been available only to large institutional investors. The Fund invests in an actively managed portfolio of “mid-market” private equity opportunities throughout Europe, targeting net returns of at least 20% per annum compounded over the long term.”

Such private equity investments I understand carry a fairly significant risk of capital loss as well as gain. Any non-UK equity holdings would also carry exchange rate risk.

Moreover, that the equity stakes are not quoted on public markets would seem to make them inherently less liquid (that is less easy to trade –especially in more testing market conditions), bringing an additional element of risk. What these private equity holdings were precisely does not seem to have been disclosed at the time, which may be part and parcel of a private equity investment, but inevitably makes the nature of the investment more opaque and the risks more difficult to judge.

The private finance element of the fund apparently involved lending money to firms who, for whatever reason, did not wish to raise money from more conventional sources such as banks or sales of shares. Arch cru described its Private Finance Fund as enabling:

“investors to access a conservative investment which aims to deliver double digit returns with low volatility and downside risk. The underlying investments are typically highly collateralised cash flow financings for companies at attractive rates driven by a scarcity of capital. Private finance is also referred to as Asset based Lending (ABL) and can include bridge financing, term lending and structured financing arrangements”.

Such targeted high returns (11-15%) and the nature of the investments being made do not sit easily with the notion of a conservative or cautious investment.

The sustainable opportunities element of the fund, from its description, consisted of equity and other holdings selected based on their perceived potential to benefit from “environmental, social and economic trends.” An equity investment would bring significant risk of capital loss and this could be exacerbated in this case by potential investment in a more limited range of sectors or firms. On the face of it, then, this element of the fund is one that would seem to have involved investments carrying a not inconsiderable risk of capital loss as well as gain.

I do note that the fact that the IMA classified the Fund as one in the ‘cautious managed sector’. But this does not mean the fund *is* low risk, or that it is not volatile, or cannot bring about significant losses. ‘Cautious Managed’ is not synonymous with ‘low risk’ and I would have expected the IFA to be aware of that. In any event the Arch cru fund cannot be easily compared with a ‘traditional’ managed fund because of the nature of its investment; the IFA should have been aware what general types of investment would be made by the fund at the outset.

Regardless of the general categorisation of the fund by the IMA or any other body, the IFA had a responsibility to make a suitable recommendation and describe the risks and the nature of those risks accurately to its clients.

Of course the potential problems with these types of investments were laid bare by the market conditions of the last few years and are now well known. So it is important to avoid the benefit of hindsight in the assessment of these matters today.

I am sure that neither the precise market conditions, nor the particular difficulties suffered by such managed funds with illiquid investments, were predicted. But the inherent risks in the retail market associated with such opaque investments were well known and are an established feature of market investments.

Overall, it seems to me that the fund presented significant risk to capital, especially because of its large 'holdings' or investment in, private finance and private equity. If such investment by the fund manager, which was entirely at its discretion, turned out to be 'wrong' in the sense that it provided lending to, or invested in, companies that entered difficulty or failed, then significant reduction in capital could occur. It would also have been foreseeable, given the nature of the investment, that liquidity issues could arise thereby preventing investors accessing their funds.

This was an unusual type of fund, operating in a very specific way and with a limited track record. It could suffer significant losses, the nature of which would be difficult to predict or estimate at outset. Comparing the performance of asset classes (particularly over relatively short timeframes – and three years is a short timeframe) is no indication of risk or the risks being taken (especially where that has occurred in generally positive market conditions). Just because the investment had a period of reasonable performance does not mean that it did not present significant risks to capital.

The simple fact was that the Arch cru fund as described in 2007/8 was not a low risk fund or one suitable for a cautious investor. Notwithstanding the generalised assurances of conservatism and consistent high returns by the fund managers, the Investment Portfolio contained a large proportion of what might reasonably be described as sophisticated and/or complex investments the nature of which was opaque. Information about how, generally, the product would operate and the nature of its investments was freely available to professional independent financial advisers.

Accordingly in my view, to an experienced financial adviser these investments would not and should not have appeared to represent a low or cautious investment risk in early 2008. Indeed I have some doubt as to whether such an investment would have been suitable for any but significantly more speculative and sophisticated investors.

So I am satisfied that, the IFA, being a professional independent financial adviser, ought reasonably to have identified those risks from the readily available description of the fund that was available at the time to the IFA and taken them into consideration when recommending the investment to Ms P and Mr M.

I turn now to consider Ms P and Mr M's needs and circumstances at the time the advice was given.

They did not it seems have a history of investing their free capital in risk based assets. Indeed, all their free investment capital was held in cash or was cash-based. They had recently arranged a fixed rate mortgage. They said they would defer discussion around retirement planning. It appears that they were of relatively modest means, and without dependents.

Ms P and Mr M say that they were cautious with their capital and did not wish to expose it to too much risk. The 'suitability report' produced at the time by the IFA (to which I refer

in more detail later) says that their “*priority was to look at some tax efficient investments that may provide you with growth opportunities over the medium to longer term that could deliver potentially better returns than cash deposits*” and notes that the IFA’s advice was limited to this need. Ms P and Mr M’s attitudes to risk was assessed and recorded by the IFA using a ten point scale ranging from “*ultra conservative*” to “*highly speculative*”. As noted above Ms P was recorded as ‘*Realistic*’ and Mr M as ‘*Cautious to Realistic*’.

I do not find these highly subjective terms to be of great assistance when considering the actual objectives and wishes of inexperienced investors. Headline terms such as “conservative”, “cautious” “realistic” “aggressive” are inherently value laden. And the language used to illustrate the meaning of these headline ratings is similarly subjective. In the risk scale used in this case *Conservative* is described as “*you prefer the security of cash and fixed interest investments, but are happy to accept a level of stock market investment necessary to provide long term security*”. Only by being “ultra conservative” would a client indicate that they prefer to “*have no investment in the stock market whatsoever and are prepared to accept the inflationary risk that this implies*”.

The ‘Realistic’ and ‘Cautious to Realistic’ definitions used in the attitude to risk scale (set out above) and variously referred to ‘low risk investment’ and ‘security’. And only at point 8 of the scale ‘Speculative’ is there any mention of “*risk of potential loss of capital*”.

No doubt Ms P and Mr M were interested in some means of improving the return they could earn on their (relatively) modest savings and of sheltering those returns from tax. And I have noted that the sum they chose to invest was a relatively small proportion of their new savings (leaving them with adequate cash for emergencies). I have also considered carefully the information it seems that Ms P and Mr M saw at the time. But having considered all these factors I find it plausible in these circumstances that Ms P and Mr M understood that they would not lose any significant portion, or indeed any, of their capital by investing. Being ‘wary of stock market volatility’ implies not wishing to expose capital to loss.

So overall, having considered the position carefully I find Ms P’s and Mr M’s representations, that they were and wished to be cautious with their capital, to be both plausible and persuasive.

The suitability ‘report’ of 23 February 2008 did not explain to any extent the risks associated with investing in the Arch cru fund – it did not mention for example that it invested in private finance and private equity, and instead merely included a fairly generic statement that unit prices could fall and rise and returns are not guaranteed.

It does not seem to me that this would have alerted Ms P and Mr M to the risks associated with this investment and it seems unlikely from the contents of the report that the adviser explained the particular risks associated with the investment or established that Ms P and Mr M were prepared to take them.

I accept the submission by the IFA that such a report could not contain every detail and ramification of investing in the fund without becoming unwieldy but it could and should have contained at least some detail of what they were investing in. There is no information to the effect that this is a rather unusual type of fund amongst its peers or any detail as to what the fund invests in. There is no detail, even basic detail, about the particular risks of this fund.

Providing generic factsheets does not fill that gap for investors such as Ms P and Mr M who would be entirely dependent on the adviser to put those risks to them in a way they

could understand. The report is one of the material methods of doing so, being addressed to them and tailored to them. The IFA says that this information was given orally but there is little evidence of that.

Overall, I do not believe it likely that Ms P and Mr M appreciated the nature of the risks and I am not persuaded that the investment was suitable for them – I think it is unlikely that they would have been prepared to accept the kind of losses this product could generate.

This is not a view reached with hindsight. I have based my findings on the product suitability for Ms P and Mr M based on what the business knew or would be expected to find out about the fund and based on a reasonable expectation of how the fund would operate. Information about how, generally, the fund would operate and the nature of its investments was available to professional independent financial advisers.

I am satisfied that this recommendation exposed the consumers to significant risk and not one which their circumstances suggest they were willing to take. The asset holdings are, in my opinion, non-standard and potentially specialist. This should have alerted the IFA to the fact that such specialist funds were unlikely to be suitable for unsophisticated investors such as Ms P and Mr M.

I have therefore concluded that:

- Ms P and Mr M were inexperienced investors who did not wish to put their capital at risk but did wish to explore the potential for better than deposit account returns for a longer term investment;
- the Arch cru fund was not a fund suitable for such investors and this should have been apparent from the information readily available to an experienced financial adviser;
- the information provided to Ms P and Mr M was not sufficient to alert them to the risks they had been advised to take.

Accordingly I conclude that the recommendation made by the IFA to invest in the Arch cru fund was not a suitable recommendation for the consumers in their individual circumstances.

c) what would Ms P and Mr M have done but for the unsuitable advice?

I have concluded the IFA's recommendation to invest in the Arch cru fund was not suitable for Ms P and Mr M. I therefore need now to consider what Ms P and Mr M would have done 'but for' the advice they received.

Ms P and Mr M invested their money in the fund on the advice of a financial adviser. They were relatively inexperienced investors, entitled to rely on the professional advice they received. I have not seen anything which suggests to me (and I find it highly unlikely) that they would have invested in the Arch cru fund, if it had not been recommended to them.

Nor am I persuaded that they would have invested in the fund if things had happened as they should – the investment was not suitable for their needs and circumstances and I do not think they would have invested had they appreciated the risks.

I have therefore considered what Ms P and Mr M would have done if they had not been advised to invest in the fund. In cases like this, the consumer's circumstances and objectives at the time of the advice often provide a good indication of what they would have done.

There is no compelling evidence from the time of sale to demonstrate exactly what Ms P and Mr M would have done if they had not invested their money in the fund.

I have considered whether they might still have invested in a way that put their capital at risk and whether in the circumstances it would be appropriate to calculate compensation by comparing their current position to the position they would have been in if they had invested in that way (for example by comparing the position with a position calculated by reference to one of the stock market indices).

But for the reasons discussed earlier in this decision, it seems unlikely given their circumstances, objectives and tolerance to risk that investing in a way that risked significant capital losses would have been an acceptable proposition to Ms P and Mr M – they were concerned about volatility and required a good degree of security with their money.

It is also possible that they might have retained their funds in deposit accounts (as that was where they held the money when they met with the IFA). But that also seems unlikely as their aim was to invest this part of their savings to obtain a better return than that would allow.

I cannot now of course be sure the decisions Ms P and Mr M would have made. But overall having considered their aims, intentions and circumstances at the time, I am satisfied that on the balance of probabilities Ms P and Mr M would still have invested in a way designed to produce a return without putting their capital at risk.

I have considered whether any further enquiries and/or an oral hearing with the parties might assist me in reaching a fair conclusion on this matter. After nearly 4 years memories of discussions will be fading and inevitably may be significantly influenced by subsequent events. But I understand I have all the relevant written material that has been retained by either party from 2008 and I am satisfied that this provides a reasonable basis for my present (provisional) decision. Accordingly my provisional view is that further enquiries by this service and/or hearings are not necessary and would not be appropriate and proportionate in the circumstances of this case.

d) fair compensation

I have found that the IFA provided unsuitable advice that was relied on by Ms P and Mr M and were it not for that poor advice, they would not have invested in the Arch cru fund.

And having considered all of the evidence and arguments, I am satisfied it would be fair and reasonable for the IFA to make good the loss (if any) Ms P and Mr M have suffered because their money was invested in the Arch cru fund when it should not have been. I have therefore considered how fair compensation should be calculated.

As noted above I am satisfied that with suitable advice Ms P and Mr M would still have invested their money in a way designed to produce a return. As I have already discussed, there is no compelling evidence about how this capital would otherwise have been 'invested', so I consider it fairest to assume:

- With reasonable advice, Ms P and Mr M would have had the original capital invested in the Arch cru fund intact plus a reasonable rate of return.
- The rate of return on the original capital would have been equivalent to 1% more than Bank of England base rate from time to time compounded yearly.

- The rate of return would have been by capital growth, rather than income, and may be taxable in Ms P's and Mr M's hands as a capital gain.

This reflects my normal approach to compensating customers for poor investment advice in cases such as these. The base+1% capital return is not shaped by any particular investment but as a proxy for a balanced view of potential outcomes that might have been achieved by Ms P and Mr M over the past 3 years given their conservative objectives and risk tolerance. In reaching that conclusion I have noted in this case that:

- the FTSE 100 has fallen by over 10% since February 2008;
- deposit accounts can presently be obtained with returns in excess of the base rate;
- Ms P and Mr M had a fixed rate mortgage against which they could have made further payments.

In reaching the conclusion that the IFA should compensate Ms P and Mr M for the losses they incurred as a consequence of investing in the Arch cru fund, I have also carefully considered the IFA's representations about the cause of the current position of the Arch cru fund and its view that Capita is to blame because it failed to properly oversee the fund. I have also considered whether the losses were foreseeable.

I am mindful of the difficult market conditions that occurred in late 2008 and since. It is sometimes said that these were not foreseeable. It is certainly the case that many did not foresee them. But in at least one sense the outcome of any investment is inherently "unforeseeable" – that is, simply put, the risk of investment. That there could be major falls in stock markets, that a range of assets are identified as having been over-valued by markets and that financial institutions and others are placed under intense financial stress may not be common circumstances, but they are not unknown to investors either. To put this simplistically even if severe market turbulence only happens three times a century – there is more than one in ten chance such an event will happen during the life of a five year investment.

In this case given the make up and investment strategy of the fund described in the brochure, it seems to me that this fund could have suffered significant losses in a wider range of market circumstances than the (relatively) extreme conditions that we have observed since 2008. These were all risks that an experienced IFA should have noted and taken into account in their deliberations.

As to the actions of the fund managers I am aware that a range of comments and allegations have been made. These are not questions I am in a position to determine in this dispute – and indeed I have no jurisdiction to consider a dispute between an IFA and a product provider or fund manager. However these considerations may in principle be relevant to the determination of fair compensation. So I make the following general observations (which are not, and are not intended to be taken as, any comment on the conduct of the managers of the Arch cru fund).

It is inherent in a managed fund that there can be criticisms of the judgement and skill of the fund managers – indeed the ability of the fund manager is one of the risks that is inherent in a managed fund. That some will manage the fund poorly (or even very poorly) is in my view an inherent and foreseeable risk.

In extreme circumstances the way a fund manager performs may fall outside the normal range of professional performance. Two broad circumstances might arise. First there may be material mis-representations upon which an adviser has relied in giving advice to his client.

In such circumstances it seems to me that both the client and the adviser might have some claim against the fund manager (but a dispute between the adviser and the fund manager could not be considered by this service).

Second, there may in principle have been negligence or fraud in the conduct of a fund. Such actions might represent a break in the “chain of causation” – that is the losses arising from the negligent initial advice may not fairly be taken to include all of the losses that the customer has suffered, because of the separate negligent or fraudulent acts in respect the management of the fund.

My approach to such cases is difficult to describe in general terms - much depends on the particular combination of circumstances. But two points can be made. First, no liability attaches to an adviser who has given satisfactory advice (even if the fund is subsequently poorly or even fraudulently managed).

Second, and in contrast, particular difficulties arise in assessing fair compensation when it seems clear that the customer would not have been in that class of investment at all had it not been for the negligent advice. In such circumstances I might assess fair compensation to be awarded against the negligent adviser as putting the customer back in the financial position they would have been in but for the poor advice notwithstanding the arguments around possible breaks in a chain of causation. Again in principle there may be causes of action of either the adviser or the client against the fund manager in such circumstances (but again I cannot consider a dispute between an adviser and a fund manager).

In the present case, whilst much press and other comment has been made about the conduct of the Arch cru fund managers, I am aware of no formal findings on these points that I should take into account in assessing compensation in this case.

However I am also mindful that Capita, HSBC Bank Plc and BNY Mellon Trust & Depositary have established a payment scheme for Arch cru fund investors, administered by Capita.

Under the terms of that scheme, which has been agreed with FSA, Capita was required to write to eligible investors setting out the investor’s entitlement by 31 October 2011. Ordinarily, investors have until 31 December 2012 to apply for payment (31 December 2014 in exceptional circumstances).

One of the features of that scheme is that the FSA has decided, as it is entitled to do, that the ombudsman service should be bound by the terms of the scheme in considering any dispute between an investor and the fund managers (strictly for this purpose any of the 3 scheme contributors). So were Ms P and Mr M to raise a separate complaint with me in respect of the actions of the fund managers I would need to follow the rules of the scheme and I would not be able to award more (or less) compensation than the scheme will provide.

Returning to the present dispute, it is my understanding that it is open to Ms P and Mr M to submit a claim for payment under the scheme and consequently to limit the extent of their loss attributable to their investment in the Arch cru fund so long as they held the Arch cru fund investment on 31 May 2011 (and still held that investment at 31 August).

It is a matter for Ms P and Mr M to decide if they want to submit a claim to that scheme. But whatever their decision, I am satisfied it would be fairest to take into account the money available to them from that source, when deciding what is fair compensation in the circumstances of this case – they would not have been entitled to that money if they had not invested in the Arch cru fund.

I would ask Ms P and Mr M to provide a copy of the offer letters they have received from the payment scheme when responding to this Provisional Decision.

If the IFA considers other firms caused or contributed to the overall loss it will incur, then it can of course pursue those firms.

my provisional decision

For the reasons set out above, I am at present minded to uphold Ms P's and Mr M's complaint. And, in full and final settlement of the complaint, I am considering ordering the IFA to pay them compensation of "E" where:

- A = the capital invested (that is £8,000), less any amounts paid out by way of withdrawals, distributions of capital or before-tax income;
- B = a return on the amount from time to time of A by way of capital growth equivalent to 1% more than Bank of England base rate compounded yearly from the date of investment to date of my Final Decision;
- C = the encashment value as at the date of my Final Decision;
- D = the compensation they are entitled to and could obtain via the redress scheme for investors in the Arch cru fund, operated by Capita in respect of Capita, HSBC and BNY Mellon;
- E = A + B – C – D, representing the investment loss.

in relation to "D":

I am aware that an independent financial adviser is seeking a Judicial Review of the FSA's decision in respect of the payment scheme, and there is media speculation about the possibility of further challenges from others.

If the payment scheme is withdrawn before 31 December 2012 preventing Ms P and Mr M from limiting their losses, then if Ms P and Mr M have not already received payment under the scheme, I am satisfied the IFA should pay them the difference ("D") at that time and within 28 days.

in relation to "E":

Payment must be made within 28 days of the date on which the business receive any acceptance of my Final Decision from Ms P and Mr M. If the business does not pay within this period then interest would be payable on any loss amount at 8% simple per year, from the date of the Final Decision until the date redress is paid.

in relation to "C":

If the fund cannot be encashed (and I understand it cannot), then for the purposes of C the investment should be treated as having a nil value, provided that Ms P and Mr M agree to the IFA taking ownership of the investment if the IFA wishes to. The IFA would then be able to obtain any value of the investment as and when that value can be realised plus any distributions made from it. I would ask Ms P and Mr M to note that carefully.

I now ask the parties to let me have, in writing, any further submissions they may wish to make.

Tony Boorman
ombudsman